

INSTRUCTIONS FOR 1997 KENTUCKY S CORPORATION INCOME AND LICENSE TAX RETURN

720S

TAX TREATMENT OF S CORPORATION AND SHAREHOLDER(S)

A corporation which elects S corporation treatment for federal income tax purposes in accordance with Sections 1361(a) and 1362(b) of the Internal Revenue Code (IRC) must file as an S corporation for Kentucky income tax purposes. Generally, income earned by an S corporation is taxed at the shareholder level rather than at the corporate level although S corporations are taxed on certain capital gains. Each shareholder includes on his return, on a pro rata basis, each item of income, loss, deduction or credit of the S corporation that can affect the computation of his tax liability. Pursuant to Section 1366 of the IRC, each such item is treated as if it were realized directly from the source from which it was realized by the S corporation or incurred in the same manner as incurred by the S corporation.

S corporations having 15 or more full-year nonresident individual shareholders with no other Kentucky income may receive special permission from the Revenue Cabinet to file a combined return in lieu of separate returns for the qualifying shareholders (see Revenue Circular 40C010). For further information, contact the Division of Tax Administration, Revenue Cabinet, Frankfort, KY 40620.

ITEMS OF SPECIAL INTEREST

Internal Revenue Code Reference Date—For taxable years beginning after December 31, 1996, the "Internal Revenue Code" for Kentucky income tax purposes means the IRC in effect on December 31, 1997, exclusive of any amendments made subsequent to that date, other than amendments which (1) provide for changes in accounting methods or (2) extend provisions in effect on December 31, 1997, that would otherwise terminate.

Amended Return—To correct Form 720S as originally filed, file an amended Form 720S and check the appropriate box on page 1. If the amended return results in a change in income or a change in the distribution of any income or other information provided to shareholders, an amended Schedule K-1 (Form 720S) must also be filed with the amended Form 720S and given to each shareholder. Check Item E(2) on each Schedule K-1 to indicate that it is an amended Schedule K-1.

Internal Revenue Service Audit Adjustments—An S corporation which has received final adjustments resulting from Internal Revenue Service audits must submit a copy of the "final determination of the federal audit" within 30 days of the conclusion of the federal audit. Use Form 720S for reporting federal audit adjustments and check the "Amended Return" box.

Limited Liability Companies—KRS 275.005 allows the formation in Kentucky of limited liability companies and limited liability partnerships. KRS 141.208 provides that any limited liability company treated as a partnership for federal income tax purposes must be treated as a partnership for Kentucky income tax purposes pursuant to KRS 141.206; and any limited liability company treated as a corporation for federal income tax purposes must be treated as a corporation for Kentucky income tax purposes pursuant to KRS 141.040.

Unemployment Tax Credit—If an S corporation has hired a Kentucky resident classified as unemployed for at least 60 days and the resident remains in the employ of the S corporation for 180 consecutive days during the tax year (a qualified person), the S corporation may be entitled to the unemployment tax credit. For each qualified person, a one-time credit of \$100 may be

claimed, not to exceed the income tax liability. The period of unemployment must be certified by the Cabinet for Workforce Development, Frankfort, KY, and a copy of the certification must be maintained by the S corporation. **KRS 141.065**

The unemployment tax credit is determined by the S corporation and then passed through pro rata to its shareholders. The credit is computed on Schedule UTC which contains detailed instructions and may be obtained from the Revenue Cabinet. To claim the credit, Schedule UTC must be attached.

Recycling/Composting Tax Credit—An S corporation, which purchases recycling and/or composting equipment to be used exclusively in Kentucky for recycling or composting post-consumer waste materials, may be entitled to a credit against the income tax imposed on the S corporation by KRS Chapter 141 in an amount equal to 50 percent of the installed cost of the equipment. Application for this credit must be made by the S corporation on Schedule RC, which may be obtained from the Revenue Cabinet. **KRS 141.390**

The approved credit is passed through pro rata to the shareholders of the S corporation. A copy of Schedule RC reflecting the amount of credit approved by the Revenue Cabinet must be attached to the S corporation's return for the year during which the equipment was purchased. The total amount of the approved credit should be entered on Schedule K. The S corporation must compute each shareholder's pro rata share by completing Parts I and II of Schedule RC (K-1), Pro Rata/Distributive Share of Approved Recycling and/or Composting Equipment Tax Credit. A copy of the completed Schedule RC (K-1) should be provided to each shareholder with their Schedule K-1 (Form 720S).

Taxable Income of the S Corporation—The taxable income of an S corporation, like that of a partnership, is defined in KRS 141.206 and is computed in the same manner as in the case of an individual under KRS 141.010(9) through (11) and the adjustments required under IRC Sections 703(a) and 1363(b). Computations of taxable income and each shareholder's pro rata share of net income, gains, losses, deductions or credits shall be as nearly as practicable identical with those required for federal income tax purposes except to the extent required by differences between Kentucky income tax law and the federal income tax law and regulations.

Income and Expenses of the S Corporation—Because the shareholders of an S corporation, rather than the S corporation, are taxed on its income and because some income and expense items are subject to special rules, it is necessary to report the S corporation's items of income, loss, expense and credit in two categories: (1) separately stated items and (2) items used to figure nonseparately computed income or loss. Nonseparately computed income or loss is the net income or loss (gross income less allowable deductions) of the S corporation computed after excluding all the items that must be separately stated. The separately stated items and the nonseparately computed income or loss are collectively known as pass through items because they are passed through to the shareholders on a pro rata basis.

Definition of Income—Kentucky income tax statutes referencing the IRC mean the IRC in effect December 31, 1997. Except for the specific statutory differences, Kentucky's definition of net income for S corporation income tax purposes is based on the federal definition of gross income in the 1997 IRC Section 61 less the deductions allowed in the 1997 IRC Chapter 1. Consequently, the amount of items of gross income and deductions should generally be the same for Kentucky income tax purposes as for federal income tax purposes except for the statutory differences.

Capital Defined—"Capital" is defined by KRS 136.070(2) and is not dependent upon the various technical definitions of capital prescribed for accounting, economics or other governmental purposes. "Capital" includes, but is not limited to, the capital stock accounts, surplus (retained earnings) accounts, intercompany accounts, advances by affiliated companies, borrowed monies (see exceptions in the following paragraph) and all other accounts which represent capital used and employed in the business, such as deferred income or taxes, customer advances and customer deposits. Equity capital required under A.P.B. Opinion 18 shall be included in capital if the S corporation elected to record such equity on its books or general ledger. **KRS 136.070(2)**

Do not include those liabilities representing customer trade accounts and trade notes payable, taxes payable, salaries payable and accounts payable. In the case of borrowed monies, the S corporation may exclude amounts directly borrowed to purchase inventory, provided the S corporation can show that the amounts excluded were specifically used to purchase inventory.

KRS 136.070 provides that the accounts comprising capital shall be reported at the value shown on the financial statement prepared for "book" purposes, i.e., the value shown on the year-end general ledger after all closing entries have been made. Amounts from various special purpose balance sheets such as "equity," "businessman's," "tax," etc., are not acceptable.

Optional License Tax Computations for Corporations Holding Stock in Other Corporations—An S corporation domiciled in Kentucky which holds stock or securities in other corporations equal to or greater than 50 percent of its total assets (investment ratio) may:

1. file a consolidated license tax return with all corporations (except those corporations exempt from tax under KRS 136.070) in which it owns directly or indirectly more than 50 percent of the corporation's outstanding stock, or
2. file a separate entity license tax return and deduct from its total capital the book value of its investment in the stock and securities of any corporation in which it owns more than 50 percent of the corporation's outstanding stock. Attach a schedule showing the computation of the investment ratio and a schedule showing the computation of the deduction listing the name of each corporation, percentage of stock owned and the amount of deduction taken. **KRS 136.071**

GENERAL INFORMATION

Who Must File—A Kentucky S Corporation Income and License Tax Return, Form 720S, must be filed by every S corporation (a) organized under the laws of Kentucky, (b) having its commercial domicile in Kentucky, (c) owning or leasing property in Kentucky, (d) having one or more individuals employed or subject to unemployment insurance tax in Kentucky or (e) which is a partner in a partnership doing business in Kentucky. **KRS 141.200 and KRS 136.090**

Required Forms and Information—Each S corporation must enter all applicable information on Form 720S, attach a schedule for each line item or line item instruction which states "attach schedule," **attach Form 1120S (pages 1, 3 and 4)** and the following forms or schedules, if applicable:

Kentucky Forms and Schedules

1. Schedule A—Apportionment and Allocation
2. Form 41A720SL—Application for Six-Month Extension of Time to File
3. Schedule K-1 (Form 720S)—Kentucky Shareholder's Share of Income, Credits, Deductions, Etc.

Federal Forms and Schedules

1. Form 4797—Sales of Business Property
2. Schedule D—Capital Gains and Losses

3. Form 5884—Jobs Credit
4. Schedules for items on Form 1120S, Schedule L, which state "attach schedule."

Substitute Forms—Any form to be used in lieu of an official Revenue Cabinet form must be submitted to the Cabinet for prior approval.

Accounting Procedures—Kentucky income tax law requires an S corporation to report income on the same calendar or fiscal year and to use the same methods of accounting required for federal income tax purposes. Any federally approved change in accounting periods or methods must be reported to the Revenue Cabinet. Attach a copy of the federal approval to the return when filed. **KRS 141.140**

Filing/Payment Date—An S corporation return must be filed and payment must be made on or before the 15th day of the fourth month following the close of the taxable year. Mail the return with payment to Kentucky Revenue Cabinet, Frankfort, KY 40620. Make the check payable to **Kentucky State Treasurer. KRS 141.160 and KRS 141.220**

If the filing/payment date falls on a Saturday, Sunday or a legal holiday, the filing/payment date is deemed to be on the next business day. **KRS 446.030(1)(a)**

Extensions—An extension of time to file a corporation income and license tax return may be obtained by either making a specific request to the Revenue Cabinet or attaching a copy of the federal extension to the return when filed. For further information, see the instructions for Form 41A720SL. **Regulation 103 KAR 15:050**

NOTE: An extension of time to file a return does not extend the date for payment of tax.

Short-period Computation of Income Tax—An S corporation filing a short-period income tax return is required to annualize taxable net income. To annualize, multiply taxable net income computed for the short period by 365 and divide by the number of days in the short period. The income tax liability shall be the tax computed on the annualized income multiplied by the number of days in the short period and divided by 365 (see Revenue Policy 41P020 for a discussion). **KRS 141.140**

Short-period Computation of License Tax—An S corporation filing a short-period license tax return resulting from a change in accounting period is required to annualize its license tax liability. To annualize, multiply the license tax liability by the number of months in the short period and divide the result by 12. **KRS 136.100**

Estimated Tax Payments—Estimated tax payments must be made by each S corporation whose income tax liability for the taxable year can reasonably be expected to exceed \$5,000. In general, the first estimated tax payment must be made by the 15th day of the sixth month of the taxable year. To determine the amount of the first payment, subtract \$5,000 from the estimated full-year tax liability, and divide the result by two. The remaining one-half is due in equal installments on the 15th day of the ninth and 12th month, respectively. The prior year's income tax liability is not a factor in determining whether a declaration of estimated tax is required. **KRS 141.044**

Failure to pay estimated tax installments equal to the amount determined by subtracting \$5,000 from 70 percent of the total income tax liability shown on the return for the taxable year will result in the assessment of an underpayment penalty. The amount of the penalty is 10 percent of the amount of the underpayment, but not less than \$25. **KRS 131.180(3) and KRS 141.990(3)**

The **Corporation Estimated Income Tax Voucher, Form 720ES**, is used to submit estimated tax payments. If the corporation is required to make estimated tax payments but did not receive Form 720ES, contact the Revenue Cabinet.

Interest—Interest at the "tax interest rate" is applied to corporation income and license tax liabilities not paid by the date prescribed by law for filing the return (determined without regard to extensions thereof).

Penalties—Penalties are:

Failure to file an income and license tax return by the filing date including extensions—2 percent of the tax due for each 30 days or fraction thereof that the return is late (maximum 20 percent). The minimum penalty is \$10. **KRS 131.180(1)**

Failure to pay income or license tax by the payment date—2 percent of the tax due for each 30 days or fraction thereof that the payment is overdue (maximum 20 percent). The minimum penalty is \$10. **KRS 131.180(2)**

Late payment or underpayment of estimated tax—10 percent of the late payment or underpayment. The minimum penalty is \$25. **KRS 131.180(3)**

Failure or refusal to file an income and license tax return or furnish information requested in writing—5 percent of the tax assessed for each 30 days or fraction thereof that the return is not filed or the information is not submitted (maximum 50 percent). The minimum penalty is \$25. **KRS 131.180(4)**

Negligence—10 percent of the tax assessed. **KRS 131.180(7)**

Fraud—50 percent of the tax assessed. **KRS 131.180(8)**

Cost of Collection Fees—20 percent on all taxes which become final, due and owing. These collection fees are in addition to all other penalties provided by law. **KRS 131.440**

FORM 720S—GENERAL INSTRUCTIONS

License Tax Filing Methods

Separate Entity—An S corporation is required to file a separate entity license tax return except as provided in KRS 136.071 and KRS 136.100(3). **KRS 136.090**

Consolidated Return—An S corporation domiciled in Kentucky which holds stock or securities in other corporations equal to or greater than 50 percent of its total assets (investment ratio) may file a consolidated license tax return with all corporations (except those corporations exempt from tax under KRS 136.070) in which it owns directly or indirectly more than 50 percent of the corporation's outstanding stock. If a consolidated return is filed, attach a schedule listing the corporations included in the license tax return and the computation of the investment ratio. **KRS 136.071**

In any case where two or more corporations merge, consolidate or otherwise combine into a single corporation after the close of the taxable year, but before the beginning of the succeeding taxable year, all factors used to determine the corporation license tax liability of the surviving corporation shall be computed on the basis of the consolidated accounting records of such corporations. Attach a schedule listing the corporations included in the return. **KRS 136.100(3)**

FORM 720S—SPECIFIC INSTRUCTIONS

Period Covered—File the 1997 return for calendar year 1997 and fiscal years that begin in 1997. For a fiscal year, fill in the tax year space at the top of the form. Failure to enter a taxable period may result in a request for a delinquent return.

Item A—Enter the S corporation's date of election.

Name and Address—Print or type the S corporation's name as set forth in the charter. For the address, include the suite, room or other unit number after the street address. If the U.S. Postal Service does not deliver mail to the street address and the corporation has a P.O. box, show the box number instead of the street address.

Telephone Number—Enter the business telephone number of the principal officer or chief accounting officer signing this return.

Kentucky Business Code Number—Enter the four-digit principal business activity code number listed in the federal Form 1120S instructions that best describes the principal business activity in Kentucky. **Note:** The Kentucky and federal business code numbers entered on Form 720S may be different if the principal business in Kentucky varies from the principal business outside Kentucky. Enter a brief description of the Kentucky activity in the appropriate box next to the Kentucky Business Code Number.

Item B—Enter the six-digit Kentucky Account Number in the appropriate box at the top of each form and schedule and on all checks and correspondence.

Prior to doing business in Kentucky, each corporation should complete a Kentucky Tax Registration Application, Revenue Form 10A100. The application is available at Kentucky Taxpayer Service Centers or from the Revenue Cabinet, Taxpayer Registration Section, Frankfort, KY 40620 (see Revenue Circular 10C030). The application may be faxed to (502) 227-0772.

If the account number is lost, please telephone (502) 564-8139.

Item C—Enter the S corporation's Federal Identification Number. See federal Publication 583 if the S corporation has not obtained this number.

Item D—Enter the S corporation's federal principal business activity number from the instructions to Form 1120S.

Item E—If any of the following conditions are applicable, please check the appropriate box:

- (a) This return is the S corporation's initial return. Complete questions 1, 2 and 3 on Form 720S, page 2, Schedule Q, Kentucky S Corporation Questionnaire.
- (b) This return is the S corporation's final return, i.e., the S corporation dissolved, withdrew its qualification, or otherwise ceased to do business in Kentucky during the taxable period.
- (c) This return is an amended return. **Submit an explanation of the reason for the amended return.**
- (d) This return is a short-period return. **Submit an explanation of the reason for the short-period return.**
- (e) A change in name or address has occurred. Submit a copy of the amendment of the articles of incorporation for a name change.

PART I—ORDINARY INCOME (LOSS) COMPUTATION

Line 1—Enter the amount from Form 1120S, Line 21, ordinary income (loss) from trade or business activities. **Attach Form 1120S, pages 1, 3 and 4.**

Additions to Federal Ordinary Income—Lines 2 and 3 itemize the differences between federal ordinary income and Kentucky ordinary income which represent additional income or unallowed deductions.

Line 2—Enter state taxes measured in whole or in part by gross or net income. "State" means any state of the United States, the District of Columbia, the commonwealth of Puerto Rico, any territory or possession of the United States or any foreign country or political subdivision thereof (see Revenue Policies 41P100, 41P110, 41P120 and 41P121 for discussion of some of these state taxes). Attach a schedule reflecting the total taxes deducted on Form 1120S. **KRS 141.010(11)(a)**

Line 3—Enter the transition amount (income) reflected on Form 762TS, Line 5, filed for the 1994 taxable year. This amount

represents the excess of the adjusted federal basis of transition property over the adjusted Kentucky basis of transition property. This difference reconciles past differences between the Kentucky and federal depreciation deduction amounts. Attach a copy of the 1994 Form 762TS. **KRS 141.0101(14)(a)**

Line 4—Enter the total of Lines 1, 2 and 3.

Subtractions from Federal Ordinary Income—Lines 5 and 6 itemize the differences between federal ordinary income and Kentucky ordinary income which represent additional deductions allowed.

Line 5—Enter the amount of the jobs credit reflected on federal Form 5884. For Kentucky purposes, the S corporation may deduct the total amount of salaries and wages paid or incurred for the taxable year (see Revenue Policy 41P090 for a discussion).

Line 6—Enter the transition amount (deduction) reflected on Form 762TS, Line 5, filed for the 1994 taxable year. This amount represents the excess of the adjusted Kentucky basis of transition property over the adjusted federal basis of transition property. This difference reconciles past differences between the Kentucky and federal depreciation deduction amounts. Attach a copy of the 1994 Form 762TS. **KRS 141.0101(14)(a)**

Line 7—Subtract Lines 5 and 6 from Line 4.

PART II—INCOME TAX COMPUTATION

KRS 141.040(5) imposes an income tax on certain capital gains of an S corporation. If the S corporation's Kentucky taxable income is more than \$25,000, and Kentucky net capital gain is more than \$25,000 and more than 50 percent of taxable income, and the capital gains are not exempt from federal income tax under IRC Section 1374, Lines 1 through 7 must be completed.

If the capital gain results in the S corporation being subject to the tax determined in either Part III or Part IV of the federal Schedule D (Form 1120S), the gain is deemed not to be exempt from tax under IRC Section 1374, and therefore, the S corporation is subject to the tax imposed by KRS 141.040(5) if the tests in the above paragraphs are met.

If the tests in the above paragraphs are not met, skip Lines 1 through 8, enter zero on Line 9 and complete Lines 10 through 20, where applicable.

Line 1—Enter the taxable income of the S corporation. Taxable income is computed in the same manner as in the case of an individual under KRS 141.010(9) through (11) and the adjustments required under IRC Sections 703(a) and 1363(b) which include all items of income, loss and expense separately stated and all items used to figure nonseparately computed income or loss reported on Form 720S. Attach a schedule used in computing taxable income.

Line 2—Subtract the statutory exemption of \$25,000 from Line 1 and enter the amount. **KRS 141.040(5)**

Line 3—Enter the net capital gain.

Line 4—Subtract the statutory exemption of \$25,000 from Line 3 and enter the amount. **KRS 141.040(5)**

Line 5—Enter the lesser of Line 2 or Line 4.

Line 6—Enter "100" or the apportionment fraction from Schedule A, Section I, Line 12, if applicable. Schedule A, Section II does not apply to S corporations.

Line 7—Multiply the amount on Line 5 by the percentage on Line 6.

Lines 8(a) through (e)—To compute the liability, apply the following rates:

- (a) 4 percent of the first \$25,000 of taxable income;
- (b) 5 percent of the amount of taxable income in excess of \$25,000, but not in excess of \$50,000;
- (c) 6 percent of the amount of taxable income in excess of \$50,000, but not in excess of \$100,000;
- (d) 7 percent of the amount of taxable income in excess of \$100,000, but not in excess of \$250,000; and
- (e) 8.25 percent of the amount of taxable income in excess of \$250,000.

Line 9—Add Lines 8(a) through (e).

Line 10—Enterprise Zone Tax Credit. For employees hired on or after July 14, 1992, an S corporation certified by the Kentucky Enterprise Zone Authority as a qualified business may be entitled to a credit against Kentucky S corporation income tax equal to 10 percent of wages paid to each employee who has been certified by the Cabinet for Workforce Development as having been unemployed for at least 90 days or having received public assistance benefits, based on need and intended to alleviate poverty, for at least 90 days prior to employment with the qualified business. The credit is limited to \$1,500 per employee, and any unused credit may be carried forward for up to five years. To claim the credit, Schedule EZC must be filed (see Revenue Circular 10C001 for a discussion). **KRS 154.45-090**

Line 11—Subtract Line 10 from Line 9.

Line 12—Enter the total of estimated tax payments made for the taxable year.

Line 13—Enter the amount of income tax paid with Form 41A720SL, Application for Six-month Extension of Time to File Kentucky Corporation Income and License Tax Return.

Line 14—Enter the amount credited to 1997 from Part II, Line 19 of the 1996 S corporation income tax return.

Line 15—Enter the license tax overpayment credited to the 1997 income tax liability from Part III, Line 23.

Line 16—If Line 11 is greater than the total of Lines 12 through 15, enter the difference on this line and submit payment.

Line 17—If Line 11 is less than the total of Lines 12 through 15, enter the difference.

Line 18—Enter the portion of Line 17 credited to the 1997 license tax liability in Part III, Line 20.

Line 19—Enter the portion of Line 17 claimed as an estimated tax payment for 1998.

Line 20—Enter the portion of Line 17 (Line 17 less Lines 18 and 19) to be refunded.

PART III—LICENSE TAX COMPUTATION

NOTE: If the Final Return box in Item E has been checked, no license tax is due. Enter -0- on Line 18 and complete Lines 19 through 25, where applicable.

Line 1—Enter the year-end balance of capital stock from the balance sheet (Form 1120, Schedule L). Capital stock consists of the issued and outstanding capital stock, less treasury stock (see Revenue Policy 41P520 for a discussion). **KRS 136.070(2)(a)**

Line 2—Enter the year-end balance of paid-in or capital surplus from the balance sheet (Form 1120, Schedule L) (see Revenue Policy 41P520 for a discussion). **KRS 136.070(2)(a)**

Line 3—Enter the year-end balance of retained earnings—appropriated from the balance sheet (Form 1120, Schedule L) (see Revenue Policy 41P520 for a discussion). **KRS 136.070(2)(a)**

Line 4—Enter the year-end balance of retained earnings—unappropriated from the balance sheet (Form 1120, Schedule L) (see Revenue Policy 41P520 for a discussion). **KRS 136.070(2)(a)**

Line 5—Enter the year-end balance of mortgages, notes and bonds payable in less than one year from the balance sheet (Form 1120, Schedule L). Borrowed monies include short-term borrowing of funds and loans from shareholders (see Revenue Policy 41P520 for a discussion). **KRS 136.070(2)(a)**

Line 6—Enter the year-end balance of advances by affiliated companies from the balance sheet (Form 1120, Schedule L). **KRS 136.070(2)(a)**

Line 7—Enter the year-end balance of mortgages, notes and bonds payable in one year or more from the balance sheet (Form 1120, Schedule L). Borrowed monies include long-term borrowing of funds and loans from shareholders (see Revenue Policy 41P520 for a discussion). **KRS 136.070(2)(a)**

Line 8—Enter the year-end balance, or portion thereof, of all other liability accounts, current and long term, that represent additional capital employed in the business from the balance sheet (Form 1120, Schedule L) (see Revenue Policy 41P520 for a discussion). **KRS 136.070(2)(a)**

Line 9—Enter the year-end balance of intercompany accounts. **KRS 136.070(2)(a)**

Line 10—Enter the year-end balance of all other accounts representing additional capital used and employed in the business from the balance sheet (Form 1120, Schedule L). Include all other unspecified accounts which are reported in the Liabilities and Stockholders Equity section of the balance sheet which are not generally categorized or which may be unique to certain businesses (see Revenue Policy 41P520 for a discussion). **KRS 136.070(2)(a)**

Line 11—Enter monies borrowed to purchase inventory if the S corporation can show by evidence submitted with the return that the monies were used to purchase inventory. If a line of credit is used, the Revenue Cabinet will accept the following types of evidence to establish that all or a portion of the borrowed money has been used directly to purchase inventory:

1. A copy of the loan agreement, or other document executed at the time the line of credit is established, stating that the sole purpose of the loan is for purchasing inventory. If such a document is submitted to the Revenue Cabinet, the lesser of the balance of the line of credit at the end of the year or the total cost of the inventory purchased for the year will be excluded from the calculation of "capital" under KRS 136.070.
2. If the corporation cannot produce documentation that the line of credit is to be used solely for the purchase of inventory, the Revenue Cabinet will allow a pro rata portion of the line of credit balance to be excluded from "capital" by using a formula to determine the amount of the line of credit reasonably attributable to the purchase of inventory.
 - (a) The amount of monies borrowed to finance inventory will be determined by multiplying the line of credit balance at the end of the taxable year by a fraction, the numerator of which is cash outlays for inventory during the taxable year and the denominator of which is total cash outlays during the taxable year.
 - (b) Any other formula sufficient to document that all or a portion of the borrowed monies are attributable to the purchase of inventory will be considered by the Revenue Cabinet upon submission.

(See Revenue Policies 41P520, 41P530 and 41P550 for discussions of borrowed monies.)

Line 12—This deduction is available only to an S corporation filing a separate entity license tax return which qualifies under KRS 136.071(1) and determines capital in accordance with KRS 136.071(1)(a) and (b). Enter the book value of the S corporation's investment in the stock and securities of any corporation in which it owns more than 50 percent of the corporation's outstanding stock. See Form 720S—General Instructions. **KRS 136.071**

Line 13—Enter the total of Lines 1 through 12.

Line 14—Enter "100" or the apportionment fraction from Schedule A, Section I, Line 12, if applicable.

Line 15—Multiply the amount on Line 13 by the percentage on Line 14.

Line 16—Multiply the amount on Line 15 by .0021. Enter the result or \$30, whichever is greater. The license tax rate is \$2.10 on each \$1,000 of capital employed in the business in Kentucky or a minimum of \$30. **KRS 136.070(1) and (5)**

Line 17—An S corporation with gross income of \$500,000 or less is allowed a credit against the license tax of \$1.40 per \$1,000 of the first \$350,000 of capital employed (maximum credit \$490). For the purpose of this credit, gross income means total taxable and nontaxable receipts and shall not be reduced by cost of goods sold, cost of assets sold or other deductions. **KRS 136.070(a) and Regulation 103 KAR 20:010**

Line 18—Subtract Line 17 from Line 16 and enter the result or \$30, whichever is greater.

Line 19—Enter the amount of license tax paid with the Application for Six-month Extension of Time to File Kentucky Corporation Income and License Tax Return, Form 41A720SL.

Line 20—Enter the income tax overpayment credited to the 1997 license tax liability from Part II, Line 18.

Line 21—If line 18 is greater than the total of Lines 19 and 20, enter the difference and submit payment.

Line 22—If Line 18 is less than the total of Lines 19 and 20, enter the difference.

Line 23—Enter the portion of Line 22 credited to the 1997 income tax liability in Part II, Line 15.

Line 24—Enter the portion of Line 22 claimed as an estimated income tax payment for 1998.

Line 25—Enter the portion of Line 22 (Line 22 less Lines 23 and 24) to be refunded.

Tax Payment Summary—The payment submitted with Form 720S must be itemized. Enter the amount of income tax payment on the Income line (Part II, Line 16), the amount of license tax payment on the License line (Part III, Line 21), the amount of interest payment on the Interest line, the amount of penalty payment on the Penalty line, and the total payment on the TOTAL line.

Signature—Form 720S must be signed by an authorized corporate officer. **Failure by corporate officers to sign the return, to complete all applicable lines on any required Kentucky form, to attach all applicable schedules, or to complete all information on the questionnaire will delay the processing of tax returns and may result in the assessment of penalties.**

SCHEDULE K-1 (FORM 720S)—KENTUCKY SHAREHOLDER'S SHARE OF INCOME, CREDITS, DEDUCTIONS, ETC.

General Instructions

Schedule K-1 (Form 720S) shows each shareholder's pro rata share of the S corporation's income, deductions, credits, etc. On each Schedule K-1 (Form 720S) enter the names, addresses

and identifying numbers of the shareholder and S corporation, complete items A, B, C, D and E. Please make sure the shareholder's name, Social Security or identifying number and other shareholder information are complete and legible. Schedule K-1 (Form 720S) must be completed and given to each shareholder on or before the day on which Form 720S is filed with the Revenue Cabinet.

A copy of each shareholder's K-1 (Form 720S) must be attached to Form 720S filed with the Revenue Cabinet. A copy shall be kept as part of the S corporation's records and given to each shareholder with instructions. The shareholder's instructions are included on the reverse side of Schedule K-1 (Form 720S). Additional copies of Schedule K-1 (Form 720S) are available from the Revenue Cabinet.

Photocopies of Schedule K-1 (Form 720S) may be used in lieu of the official schedule printed by the Revenue Cabinet, provided the photocopies are on bond paper of at least 16 pounds and are of good quality. The S corporation may find it more convenient to make photocopies of the schedule than to order the schedule from the Cabinet. If photocopies are made, be sure to give each shareholder a copy of the shareholder's instructions for Schedule K-1 (Form 720S) included on the reverse side of the official schedule. Prior approval from the Cabinet to use photocopies of Schedule K-1 (Form 720S) is not required.

Specific Instructions

Federal instructions for Schedule K-1 (Form 1120S) explain the rules to follow for allocating items of income (loss), deductions, credits, etc., to each shareholder. The total pro rata share items (Column (b)) of all Schedules K-1 should equal the amounts reported on the same lines of Schedule K, Lines 1 through 19. The other lines do not correspond, but the instructions will explain the differences.

Multiple Activities—If items of income, loss or deduction from more than one activity are reported on Lines 1, 2 or 3 of Schedule K-1 (Form 720S), the S corporation must provide information for each activity to its shareholders. See **Passive Activity Reporting Requirements** in the instructions for Schedule K-1 (Form 1120S) for details on the information to be provided on an attachment to Schedule K-1 (Form 720S) for each activity.

At-Risk Activities—If the S corporation is involved in one or more at-risk activities for which a loss is reported on Schedule K-1 (Form 720S), the S corporation must report information separately for each at-risk activity. See **Special Reporting Requirements for At-Risk Activities** in the federal instructions for Schedule K-1 (Form 1120S) for details on the information to be provided on an attachment to Schedule K-1 (Form 720S) for each at-risk activity.

Lines 1 through 19—Enter the shareholder's total pro rata share of each item listed on Schedule K, Form 720S. **Do not multiply these amounts by the percentage entered on Item D(2).** Attach schedules showing separately the required information for each IRC Section 469 passive activity and each Section 465 at-risk activity. Other schedules are to be attached for line items where requested on Schedule K-1 (Form 720S).

Line 20—Enter on attached schedules the supplemental information required to be reported separately to each shareholder for Lines 1 through 19 and any other information or items and amounts not included on Schedule K-1 (Form 720S) that the shareholder needs to prepare a Kentucky income tax return including, but not limited to, any recapture of Section 179 deduction, gross income and other information relating to oil and gas well properties enabling the shareholder to figure the allowable depletion deduction, etc. See instructions for federal Schedule K-1 (Form 1120S), Line 23.

Lines 21 through 23—The amounts in Column (b) are to be entered by the shareholder, not the S corporation.

TAXPAYER ASSISTANCE

Forms:

Support Services Branch
Revenue Cabinet
200 Fair Oaks Lane
Frankfort, KY 40620
(502) 564-3658
(502) 564-4459 (Forms by fax)
<http://www.state.ky.us/agencies/revenue/revhome.htm>
(Internet)

Information:

Corporation Tax Section
Revenue Cabinet
P.O. Box 1302
Frankfort, KY 40602-1302

Revenue Cabinet
200 Fair Oaks Lane
Frankfort, KY 40620
(502) 564-4581
(502) 564-3058 (Telecommunication Device for the Deaf)

KENTUCKY TAXPAYER SERVICE CENTERS

Information and forms are available from Kentucky Taxpayer Service Centers in the following cities.

Ashland, 134 Sixteenth Street, 41101-7670
(606) 920-2037

Bowling Green, 1502 Westen Street, 42104-3356
(502) 746-7470

Corbin, Falls Road Plaza
1707 18th Street, Suite 5, 40701-8676
(606) 528-3322

Hazard, 233 Birch Street, 41701-2179
(606) 435-6017

Hopkinsville, 105 Hammond Plaza
4011 Ft. Campbell Blvd., 42240-4929
(502) 889-6521

Lexington, 301 East Main Street,
Suite 500, 40507-1556
(606) 246-2165

Louisville, 620 South Third Street
Suite 102, 40202-2446
(502) 595-4512

Northern Kentucky, Turfway Ridge Office Park
7310 Turfway Road, Florence, 41042-1385
(606) 371-9049

Owensboro, Building C, Suite 201
401 Frederica Street, 42302
(502) 687-7301

Paducah, Paducah Bank Building, Suites 302/306
555 Jefferson Street, 42001-1001
(502) 575-7148

Pikeville, 5333 North Mayo Trail, 41501-8230
(606) 433-7675

INTANGIBLE PROPERTY TAXES—The listing period for intangible property is January 1 through May 15 of each year. Each taxpayer is responsible for reporting intangible property subject to ad valorem taxation. The Intangible Property Tax Return, Revenue Form 62A376, and instructions are included in this packet.

TANGIBLE PERSONAL PROPERTY TAXES—The listing period for tangible personal property is January 1 through May 15 of each year. Each taxpayer is responsible for reporting his tangible personalty subject to ad valorem taxation. The Tangible Personal Property Tax Return, Revenue Form 62A500, and instructions can be obtained from the Department of Property Taxation or your local county property valuation administrator's office. A separate form must be filed for each location in Kentucky where you have tangible personal property.

Kentucky Revenue Cabinet Mission Statement

To provide courteous, accurate and efficient services for the benefit of Kentucky and its citizens, and administer the tax laws of the Commonwealth in a fair and impartial manner.

The Kentucky Revenue Cabinet does not discriminate on the basis of race, color, national origin, sex, religion, age or disability in employment or the provision of services.